

TESTIMONY OF TREASURER DEBORAH B. GOLDBERG

Introduction and Economic Outlook

Secretary Lepore, Chairwoman Spilka – congratulations on your new leadership role – Chairman Dempsey, and Members of the Committee – I thank you for the opportunity to testify this morning on the state’s revenue projections and fiscal outlook.

Yesterday, I had the great privilege of being sworn into office as your treasurer. I pledged to protect the financial security and prosperity of people from all walks of life – to ensure that both our state and our people have economic stability and security, opportunity for personal empowerment.

I am upbeat and optimistic about our economic prospects here in the Commonwealth – from steady job growth, to consumer spending and wages on the rise, to the highest bond rating in our history.

Yet as proud as I am of our progress, I know we cannot be complacent. People deserve continuous innovation and creativity, consistent transparency and even more responsible fiscal planning from state government.

And today’s hearing marks a critical step in our planning process.

Budget Planning and Stabilization Fund

This budget crisis presents an opportunity to both reaffirm and establish critical fiscal policies. Rating agencies look to see how states handle challenging times. I share Governor Baker’s commitment to fiscal responsibility and look forward to working with each of you, in a partnership, to increase our rainy day fund significantly over the next four years. Rating agencies and investors alike consistently point to our reserves as a source of fiscal strength, and building those reserves will be essential as we strive toward achieving an even higher bond rating.

Massachusetts State Lottery

Lottery profits provide the number one source of unrestricted local aid for our 351 cities and towns. And for more than four decades, the Lottery has combined innovative strategies and a customer-centered approach to produce impressive results. In FY 2014, the Lottery produced more than \$4.86 billion in sales, resulting in \$974 million of net profit.

Momentum has continued into FY 2015. Overall year-to-date Lottery sales have increased by \$120.9 million, or 4.6 percent, over last year.

In fact, the Lottery has just wrapped up its most successful holiday sales period in its history. During a 10-week period from early November to early January, we generated \$972 million in sales – a \$51.7 million or 5.6 percent increase compared to last year’s holiday sales period.

And several other offerings, including Instant Ticket, KENO and Mass Cash have seen significant year-over-year sales increases.¹

¹ To date, several offerings within the Lottery’s portfolios of games have produced significant year-over-year sales increases. Instant Ticket sales have increased \$125.7 million or 6.95 percent. KENO sales have

None of this growth is by accident. From our \$30 Instant Ticket, to revamped game mechanics and appearances, to innovative promotional programs, to increased advertising, our strategic initiatives have positioned us to create the future, not sit around and wait for it.

When other Lottery games have failed to perform as expected, most notably the multi-state jackpot Powerball and Mega Millions games, we have adjusted our marketing strategy accordingly and reached out to Lottery officials in other states to listen and learn from their experiences.²

While overall FY 2015 sales are on the rise, a gradual shift in player purchases toward higher priced games that offer higher prize payouts has forced us to adjust our budgeted annual prize payout from 72.3 to 72.7 percent. This shift has mitigated the positive impact of increased sales to the bottom line.³

Although the Lottery continues to budget 72.7 percent for prize expenses, I am pleased to report today that we remain on track to meet our FY 2015 net profit projection of \$947 million. We have benefited greatly from a \$3 million increase to our advertising appropriation, a relatively mild winter as well as a balanced product and game mix.

Looking ahead to FY 2016, I am confident in the Lottery's ability to post another year of strong profits for our 351 cities and towns, but I also remain keenly aware of the new challenges we will encounter.

In FY 2016 we will see an additional \$20 million impact to the Lottery's prize payout that will be awarded this fall – the result of a second chance prize from a 2009 Instant Ticket game.⁴

increased \$20.9 million or 4.74 percent. Mass Cash sales have increased \$2 million or 5.15 percent, and Numbers Game sales are up nearly \$1 million or 0.43 percent.

² Powerball and Mega Millions games are experiencing sales declines or no growth in FY 2015 of \$20 million or 30 percent and flat sales respectively due to what is known in the industry as “jackpot fatigue” – players not jumping into the game until the jackpots offer very large prizes. Not long ago, that threshold to draw the interest of casual consumers who do not traditionally play the Lottery was \$100 million, but due to \$500 – \$600 million plus jackpots offered in the last two to three years that number has increased to \$300 – \$400 million. It is becoming increasingly difficult to grow jackpots and game sales. The Lottery is utilizing jackpot awareness radio advertising, as well as digital and platforms in an effort to attract players to lower jackpots that has helped to mitigate losses, however, it is also in discussions with other state lotteries offering the games to determine how to best address and counter fatigue in these multi-state offerings.

³ Nearly 50 percent of all Instant Ticket sales in FY 2014 derived from \$10, \$20 and \$30 games. To date in FY 2015, this percentage has increased to 53.7 percent.

⁴ This prize is the official close of an Instant Ticket Mega Cash game that was released in October 2009 and officially sold out in August 2014. The Lottery eliminated the practice of offering Instant Tickets such as this with large end of game second chance prizes that are designed to be awarded one year after game sales have ended. The Lottery's current practice is to design second chance prizes to be awarded at certain marks within the sales period of the game so there are sales within the corresponding fiscal year to offset the prize expense. There is one additional game in market, Billion Dollar Blockbuster, which was released in September 2007 and also offers a large end of game second chance prize of \$1 million a year for life. It is anticipated that this game, due to its 65.5 million ticket print run, will not sell out for another five to six years. Accordingly, the second chance prize will impact the FY 2020 or FY 2021 prize payout figures.

In addition, the Lottery must operate in a rapidly evolving marketplace and will soon face competition from a slots parlor and casinos fighting for disposable income dollars. The Plainridge slots facility is slated to open this summer, and two licensed casinos will be operating in the state within the next few years.

To address these challenges in FY 2016 and beyond, the Lottery must continue to develop solutions to retain and attract new players and remain relevant in an increasingly crowded marketplace. It is imperative that we continue to innovate and lead with proactive, not reactive strategies!

I thank my colleagues in the Legislature here today for their support of the more than \$65 million that the Lottery received in the state's IT bond bill last. This capital funding authorization will enable the Lottery to replace its terminal hardware, host system, terminal applications, and related components to better serve the public.

For several years at this hearing, you have heard that major components of the Lottery's operating system have been declared or considered for "end of life" designation by their manufacturers. As a result, maintaining and repairing this aging system is increasingly difficult as well as costly. The system is 18 years old!

I am excited to announce that within the coming week, we will be putting out to bid the replacement of the Lottery's outdated operating system and terminal hardware. This is a major IT infrastructure upgrade that is long overdue.⁵ You know those big terminals, the blue boxes that print the tickets you see everywhere – they are going! This new system will increase our capacity to be innovative and savvy.

In line with our efforts to maximize the profits of each game, the Lottery will continue to closely monitor and evaluate the sales performance of its game portfolio, seeking new initiatives to attract players.

First, we will expand the Lucky for Life draw game from six states in New England to a total of 16 and Washington, D.C.⁶

⁵ The Lottery received \$65.5 million in the state's IT Bond Bill that was signed in July 2014. This capital funding authorization will enable the Lottery to replace its terminal hardware, host system, terminal applications and related components. The Lottery has carefully constructed Request for Responses that will go out to public bid in the coming days. It is the Lottery's goal to have contracts awarded and a new system rolled out in early FY 2017 through a seamless transition without interruption to game sales.

Additionally, the Lottery is currently reviewing proposals and hopes to soon award a contract to upgrade and replace its Agent Communications Network Service, which enables game wagers to be placed and confirmed at each of the 7,500 licensed retailers statewide. Verizon will discontinue the current technology by December 2015. There will be increased costs to the Lottery in FY 2016 because retiring the existing system and migrating over to a more advanced network will necessitate that the Lottery run parallel systems for a period during this migration. This will ensure that retailers can continue to place bets with no loss of revenue. Once completed, however, the initiative is estimated to bring down the network cost by as much as 40 percent per agent terminal.

⁶ Starting January 27, the Lucky for Life draw game will expand from its current six New England states footprint to the District of Columbia and a total of 16 states, including Arkansas, Delaware, Idaho, Iowa,

Second, we will revamp and retool the graphics for KENO, the Lottery's second highest grossing game offering, and we project a \$15 million increase in the game's sales in FY 2016.⁷

Third, we will work collaboratively with other members of the Multi-State Lottery Association (MUSL) to discuss changes to the Powerball jackpot game to increase interest among players who are currently not motivated to get in the game due to "small" under \$100 million jackpots.

Fourth, we will replace the Jackpot Poker game, which was launched in June 2013 but despite modifications introduced in its first year, has fallen far short of expectations. By early 2016 we expect to replace the game with a more customer-friendly alternative.

Taking into account both the challenges we face and the solutions we have developed, the Lottery anticipates that it will return \$925 million in net profits to the state in FY 2016. This projection assumes level funding of the Lottery's \$8 million advertising appropriation.

A \$3 million increase in the Lottery's advertising budget from \$5 million in FY 2014 to \$8 million in FY 2015 enhanced our marketing, enabling us to reach markets outside of Boston and connect with new audiences through digital and mobile advertising.

As our data has documented repeatedly over the years, sales directly benefit significantly from increased consumer awareness generated through integrated advertising campaigns.

Increased advertising dollars have produced a return on investment of better than two to one! In fact, the recent holiday advertising campaign was even more successful, generating \$5 in profit for every \$1 spent on advertising.⁸

To fully maximize the net profit returned to our 351 cities and towns, I would respectfully request that the Lottery be enabled to expand its paid advertising program in FY 2016.

Kentucky, Michigan, Minnesota, Missouri, Montana and South Carolina. The expanded game will offer larger lower-tier prizes and better odds at winning the \$1,000 a day for life top prize – 1 in 30,821,472 versus the current odds of 1 in 41,391,714. This should serve to generate excitement amongst current, lapsed and new players as well as reinvigorate game sales for the second half of FY 2015 and well into FY 2016.

⁷ In FY 2014, KENO produced \$815 million in sales.

⁸ This was most recently demonstrated with the multi-media campaign that promoted Massachusetts Lottery tickets as gifts that people are "happy to give and happy to get" during the holiday season. The statewide holiday campaign included TV, radio, digital and out-of-home advertisements. There was also a 15-second TV spot supporting the Lottery's Season Ticket subscription program, the first ever TV spot dedicated solely to the program. The Lottery spent a total of \$1,920,626.83, including \$413,138.83 on production and \$1,476,119.28 on media for this holiday campaign and generated \$972,306,338 over the 10-week period. This equated to a \$51.7 million, or 5.61 percent year-over-year sales increase. The Lottery continues to capitalize on this momentum with a statewide radio and digital media campaign that is just wrapping up in support of the five new Instant Tickets released in early January. It will follow up with a three-week long advertising campaign to support the newly expanded Lucky for Life game. From January 27 to February 21, TV, radio, digital and social media ads generating additional buzz around the expanded game with more prizes and more winners will air statewide.

As a businesswoman, I firmly believe that the last thing you do when you're trying to increase revenue is cut advertising. And especially not when new competition is moving into your backyard.

At \$8 million, Massachusetts ranks last in the nation in advertising dollars as a percentage of sales.

States that generate a comparable level of sales, including Florida, California and New York, for example, have respective advertising budgets of \$37.5 million, \$65 million and \$92.2 million.⁹

States of similar size, such as Washington and Arizona, have advertising budgets of \$10.5 million and \$15 million, respectively, yet generate sales of \$594 million and \$723 million.

With a budget of \$10 million the Lottery would continue to innovate with cost-effective, efficient promotions and maximize our opportunity for increased revenue and profit return.

With an advertising budget of \$10 million, the Lottery's profit projection for FY 2016 will increase from \$925 million to nearly \$930 million.

I find the proven investment compelling and worthy of further discussion with my colleagues in the Legislature.

Unclaimed Property

Our Unclaimed Property Division continues to deliver exemplary service to citizens in communities across the Commonwealth. It now leads the nation in the amount of unclaimed property per capita returned to its rightful owners.

In FY 2014, we returned more than \$112.3 million in unclaimed property. For FY 2015 and FY 2016, we project that the Division will return \$114.4 million and \$117.1 million respectively.

Our continued focus on outreach, creative marketing and increased customer-service staffing has helped drive this successful trend.

With respect to reversions to the state for revenue purposes, I am pleased to report that we project a reversion of more than \$77 million for FY 2015, a figure \$10 million more than originally projected because of additional gains that will be realized due to a stock liquidation.

You may notice in the data included in your packet that the reversion number has fluctuated significantly over the past five years, particularly in FY 2012 when the Division's reversion was more than \$183 million. That figure reflected a one-time consolidation of stock and security sales that is typically spread out over several years. Both FY 2012 and FY 2013 reversions also included one-time settlements from life insurance companies and other non-recurring funds that produced unusually high reversions. In FY 2016, we do not anticipate to receive such large one-

⁹ The Massachusetts Lottery also continues to strive toward maximizing revenues and resulting net profit. While the organization has produced sales growth of nearly half a billion dollars and increased profits by \$100 million over the last four years, it has done so while maintaining the lowest administrative costs in the lottery industry at just 2 percent of overall revenues.

time settlements, and accordingly, our projected reversion is a similar figure to this year's projection – slightly more than \$75 million.

ABCC

With respect to revenue collection from the ABCC, in FY 2014 the Commission collected approximately \$4.23 million in revenue through license fees, fines and license processing fees. The Commission projects a similar revenue collection figure for FY 2015 and a figure of \$4.1 million for FY 2016.¹⁰

Pension Fund Assumed Rate of Return

Before closing, I would like to comment on the anticipated rate of return for our state pension fund. Two years ago, the Public Employee Retirement Administration Committee (PERAC), in conjunction with the Treasurer's Office and Administration and Finance (ANF), lowered the anticipated rate of return from 8.25 to 8 percent.

Yet if we are honest with ourselves, even at 8 percent, our anticipated rate of return remains slightly higher than the national average. The pension fund's 10-year return gross of fees is actually 7.4 percent, and admittedly, that includes the results of the financial crisis, the worst financial downturn in our lifetimes. And while we calculate our assumptions based on future, not historical projections, I strongly believe that with interest rates at historic lows, and expected market returns similarly low, the prudent and responsible course of action is to lower that figure to 7.75 percent.

In 2003, less than 3 percent of the pension funds in the state used an anticipated rate of return of 7.9 percent or lower. Today, 70 percent of them do!

Yes, this change will increase our unfunded liability. But fiscal responsibility demands planning beyond best-case scenarios in a strong economy. I have no doubt that the investor community and the rating agencies will applaud our shared commitment to disciplined fiscal management and prudent investment standards.

Conclusion

Yesterday, you heard me pledge to serve and protect the financial security and prosperity of people across the state. I view our conversation today as an essential building block to turn our shared agenda for long-term sustainable economic growth into reality.

Thank you for the opportunity to testify today. I know this is first of many conversations that we will share in the coming weeks and months as we assist you in preparing accurate revenue projections for the upcoming fiscal year.

My colleagues and I will be happy to answer any questions you may have.

¹⁰ In FY 2014, in collaboration with the DOR and DUA, the ABCC collected approximately \$13.9 million in outstanding taxes, fines and debt owed to the Commonwealth. As of January 2, 2015, the ABCC has collected approximately \$3,458,000 in revenue and has assisted DUA in collecting \$5,989,215 in revenue.